529 – Why This Savings Plan May Not Be for You.

What are 529 Plans?

529 Plans are education savings plans sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code. ***Contributions to 529 plans are not deductible on your Federal Income Tax Return*** but many states allow an income tax deduction. Please note that other states, such as California, Delaware, Hawaii, Kentucky, Maine, New Jersey, and North Carolina, do not allow deductions for contributions. 529 Plans are also subject to limitations on contributions and beneficiary expenses. With the recent change in the tax law, 529 Plans now can be utilized to pay up to $10,000 per student annually towards elementary or secondary school tuition.

The Benefits

Earnings and distributions to beneficiaries are generally not subject to Federal or State Income Taxes if they are used for eligible elementary, secondary or collegiate education related expenses. These plans also allow account holders to change investment options and beneficiaries, as well as still benefit from a home state 529 plan. They may also provide protection from creditors. Parents can accelerate the funding of a 529 account by using their annual exclusion gift amount (currently $15,000 per annum) and using a special feature of 529 plans that allows the pre-funding of up to five years of contributions gift tax-tax free ($75,000 per person or $150,000 if filing jointly). This capability is commonly known as “super-funding” and does not incur federal gift taxes.

The Pitfalls

Contributions to 529 accounts are treated as gifts for Federal gift tax purposes. Clients must weigh the benefits of the state income tax deduction against the estate tax benefits of directly paying for education and funding an annual exclusion trust. Parents who are trying to minimize estate taxes should consider annual gifts to an annual exclusion trust or another estate planning vehicle. Another factor which merits consideration is that the earnings portion of money withdrawn from a 529 plan which is not spent on eligible expenses is subject to income taxes, a 10% federal tax penalty and the possibility of the recapture of any state tax deductions or credits taken. In addition, fees associated with a 529 plan vary, so the selection of an appropriate state is critical.

The Takeaway

Setting up a 529 plan is both an investment and estate planning decision.

What’s Next?

Please contact Kara Boccella to determine which investment and estate-planning strategies are right for you and allow her to craft a proprietary plan that includes proper documentation, time frames and amounts necessary to provide for the educational needs of your beneficiaries while maximizing your tax benefits.

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Kara S. Boccella has over 25 years of experience advising legal professionals, executives, entrepreneurs, high net-worth individuals and families.

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